



Montana Department of Highways Civil Rights Newsletter

JULY 1989

1989 Assistance For Business Clinic

(Formerly Small Business Clinics)

Unemployment Insurance, Workers' Compensation and Employment Relations Division of the Department of Labor and Industry, The Montana Department of Revenue, Internal Revenue Service and the Small Business Administration are joining together to conduct Assistance for Business Clinics throughout Montana in 1989.

Fall Schedules

<u>Date</u>	<u>City</u>	<u>Location</u>
9/6	Bozeman	MSU Student Union
9/7	Butte	Copper King Inn
9/12	Lewistown	Yogo Inn
9/13 9/14	Billings	EMC Liberal Arts Building
9/27	Helena	Colonial Inn

Name Change

T.P Construction of Hysham, a currently certified DBE, has changed the company name to Werhonig Enterprises, Incorporated, doing business as Wercon, Inc. The corporation is 100% owned by George L. Werhoning. The address and phone remain the same.

1989 Montana Bid Letting Dates

The Montana Highway Commission has approved the following bid letting dates for 1989.

July 27	August 24
September 28	October 26
December 7	

1989 Bid Letting Dates

Following is the 1989 schedule of bid lettings for North Dakota and South Dakota.

North Dakota

September 22	November 17
--------------	-------------

South Dakota

August 15	September 19
October 17	November 14

DBE Meeting Room Cancelled

MDOH is no longer sponsoring a meeting room at the Colonial Inn the evening prior to bid letting.

New Certifications

The following firms were certified as of June 1989.

Harvey Ost Oilfield Service, P.O. Box 128, Fort Peck, MT 59223. Phone: (406)526-3218. Owner: Ethel M. Ost. The firm is a highway related WBE and provides water hauling services.

Interstate Roofing and Sheetmetal, Inc., 6055 N. Government Way #9, Couer d'Alene, ID 83814. Phone: (208)772-5538. Owner: Judy Whatley. The firm is a non-highway related WBE and is a roofing and sheetmetal contractor.

Recertifications

The following firm was recertified as of April 1989.

I. Horstein Painting, Missoula, MT

The following firm was recertified as of May 1989.

S & L Construction, Butte, MT

The following firms were recertified as of June 1989.

Artistic Creations, Helena, MT
Lisa Bay Consulting, Helena, MT
Hout Fencing, Miles City, MT
Lolo Glass, Lolo, MT
Pace Construction, Bozeman, MT
Perry Crane & Rigging, Townsend, MT
Poteet Construction Co., Inc., Missoula, MT
Temp-Right Services, Inc., Missoula, MT
Wells Engineering, Inc., Denver, CO

The following firms were recertified as of July 1989.

BAC-CO, Wolf Creek, MT
Blackdigger Enterprises, Inc. Billings, MT
DuMontier Oil Company, Ravalli, MT
East-West Construction, Inc., Froid, MT 59226
Curtis Hagfeldt Construction, Great Falls, MT
Livery Travel Corporation, Helena, MT
Mann Trucking, Wolf Point, MT
Mechanical Technology, Inc., Billings, MT
Morning Star Enterprises, Inc., Lame Deer, MT
Poly-Carb, Inc., Solon, OH

Certification Expirations

The following firms have allowed their certifications to expire.

Little Shell Contractors, East Helena, MT, May 1989

Carter's Mobile Home Service, Billings, MT, May 1989

Martinez Enterprises, Kennewick, WA, June 1989

West Line Construction, Inc. (Westco), Olympia, WA, June 1989.

The Civil Rights Newsletter is published on a monthly basis by the Montana Department of Highways' Civil Rights Bureau.

Raymond D. Brown, Chief
Civil Rights Bureau
(406) 444-6333

Vicky A. Koch
EEO Program Officer
(406) 444-6335

Rick Leavell
DBE Program Specialist
(406) 444-6375

Rich Munger
DBE Program Specialist
(406) 444-7609

Sam Prestipino
Compliance Specialist—Labor Compliance
(406) 444-6334

Misty Hammerbacker
Program Specialist
(406) 444-6337

Debbie Johnke
Program Assistant
(406) 444-6332

Kathleen Palmer
Administrative Aide
(406) 444-6331

CIVIL RIGHTS NEWSLETTER PUBLISHED QUARTERLY

The Civil Rights Newsletter, which in the past has been published monthly, will be published quarterly beginning with this issue.

The newsletter will be issued in January, April, July and October of each year.

CONTRACTING REBOUNDS 9 PERCENT

April contracting rebounded 9 percent from the slow-starting first quarter of 1989, reports the F.W. Dodge Group of McGraw-Hill Information Services Company.

The value of newly started construction projects rose to an annualized \$256.8 billion in April, up from \$236.1 billion in March.

"It remains to be seen whether April's surprising improvement will have staying power," commented George A. Christie, vice president and chief economist for F.W. Dodge, "but it does show that the construction sector so far is taking this year's higher interest rates in stride instead of collapsing into a downward spiral."

Residential building contract value rose 16 percent in April to an annualized \$126.1 billion. Gains were reported in all major categories of residential construction, including a modest improvement in one-family building. "The stability of the normally credit-sensitive one-family sector is encouraging and offers a reason for guarded optimism about the housing outlook for the rest of 1989," Christie said.

The value of nonresidential building climbed to \$82.2 billion in April, a 5 percent increase over March's annualized rate. The latest month's improvement was concentrated among institutional buildings, as both schools and health care facilities scored gains of 10 percent. Contracting for commercial and industrial buildings was held to an increase of 2 percent, and office construction remained weak.

The most strength during April came from the nonbuilding sector, which came within one percent of March's high rate of newly started projects. The April value of \$48.5 billion included two major sewage/waste treatment projects.

However, nonbuilding for the year is still 5 percent off the pace set in 1988.

Overall, the \$75.7 billion in construction value for 1989 is 2 percent below the total set during the same period last year.

Region by region, the West is holding steady with the construction totals from last year, while the South is lagging behind 1988 by 7 percent. Both the Northeast and North Central regions showed gains of 1 and 2 percent, respectively.

Excerpt from the May 29, 1989 Intermountain Contractor.

REMINDER

EEO 5 REPORTS

FOR JULY

ARE DUE IN

THE CIVIL RIGHTS

BUREAU AUGUST 10, 1989

Payroll Errors

When payroll errors are identified by the MDOH Field Project Manager (FPM), one of the following must occur as specified in the Civil Rights Manual on page II.A.19:

(a) have the correction made in the field as long as that correction does not alter an individual's earnings. For example, an incomplete classification can be corrected at the [contractor's] field office. These types of corrections must be initiated by the contractor's superintendent and the FPM. The payrolls cannot be returned to the Company's home office for correction.

(b) request supplemental payrolls from the contractor's headquarters office, which affect a change in an individual's earning require a supplemental payroll cannot be returned to the contractor for correction. Both the original and supplemental payrolls must be submitted to the Civil Rights Bureau.

Also, when problems occur on a subcontractor's payroll, the FPM must go through the Prime Contractor when requests are made.

If you have any questions call either Misty Hammerbacker or Sam Prestipino at (406)444-6331.

NEW DRUG LAW PUTS HEAVY RESPONSIBILITY ON SUPERVISORS

(Susan D. Oglebay is assistant prosecutor for Smyth County, Virginia, and is also in private practice in Damascus, Virginia, where she concentrates on employment discrimination and other areas of employment law.)

"New responsibilities for complying with the Drug-Free Workplace Act of 1988 may fall disproportionately on supervisors and managers," asserts attorney Susan D. Oglebay. "That's because the main thrust of the new act is getting the employer's anti-drug policy to employees and seeing that it is observed," she adds. "But the new act is so vague on who must do what, when and where, it is likely to increase liability for both employers and supervisors.

The Drug-Free Workplace Act of 1988, for which final regulations were recently issued, covers federal contractors and subcontractors — which means just about any company of any size — and entities receiving federal grants. The minimum size of contracts covered is \$25,000. Penalties for infractions can be severe, including loss of federal contracts for up to five years.

If you are unsure whether your employer qualifies as a contractor or subcontractor under the new law, Oglebay recommends having upper management ask the federal agency holding your contract for an opinion.

She describes briefly the employer's and supervisor's obligations under the new law:

1. To explain to employees the dangers of drug abuse in the workplace.
2. To establish a "drug-free awareness program" and a policy of maintaining a drug-free workplace. (Oglebay notes that the new law does not define precisely what a "policy" or "program" is.)
3. To warn employees what specific penalties "may" be imposed for drug-abuse violations.
4. To inform employees of the existence of any rehabilitation or counseling programs.

Oglebay advises what steps supervisors and employers must take to meet these obligations:

- **You must establish a "drug-free awareness program" and explain to employees the dangers of drug abuse in the workplace.** Any employer covered by the new act is required to make sure all employees working on a qualified federal contract or subcontract (\$25,000 or more) receive a statement notifying them that "possession, manufacture, distribution, dispensation or use of a controlled substance in the workplace is prohib-

ited." This statement must include the employer's expressed desire to maintain a drug-free workplace, and make clear the consequences of violations — what kind of punitive actions "may" (but not necessarily "shall") be taken, including warning, suspension, and termination. As an alternative to punishment, an employer may require satisfactory participation in a drug rehabilitation program.

- **You must get each employee's agreement to abide by the terms of your employer's policy.** For example, the law says that after being informed of your employer's policy, any employee who is convicted of criminal "possession, manufacture, distribution, dispensation or use of a controlled substance in the workplace" is required to notify your employer within five days of a conviction. Then the employer must notify the federal agency giving the contract.

- **You must make a "good-faith effort" to maintain a drug-free workplace.** "This responsibility is likely to fall on the supervisor's shoulders," Oglebay comments, "because it is the supervisor who ends up communicating with and monitoring employees day to day." To demonstrate your employer's good faith from the outset, she recommends holding a brief 20 to 30 minute seminar explaining your employer's anti-drug-abuse policy, then following up with brochures on the importance of a drug-free workplace. "You can get excellent, inexpensive brochures from the National Institute of Mental Health," she suggests. "They make both good handouts and convenient paycheck stuffers. This kind of good-faith effort may be important in preserving your contract if your employer is ever questioned over violations."

- **You should get each employee to sign a statement acknowledging receipt of your employer's policy.** Although technically the new law covers only employees working directly on a federal contract or subcontract, the act offers no criteria for deciding who is working on one and who is not. For example, are cafeteria workers covered if they serve employees working on the contract? What about the accounting employee whose responsibilities include processing invoices for the contract? "It may be safest to ask every employee in the company to sign a statement," Oglebay advises.

Sample Employee Statement

Oglebay recommends including in the signed statement a surrender of certain privacy expectations to avoid lawsuits for invasion of privacy.

She offers a sample statement (see box on page 5), but advises consulting with Personnel or the appropriate company official before asking employees to sign it.

"Since convictions are matters of public record, normally they carry no privacy rights," Oglebay affirms. "But a surrender of privacy expectations in the signed

NEW DRUG LAW, continue on page 5

NEW DRUG LAW, continued from page 4

statement can protect you if you end up dealing with someone under 18 years of age, or someone convicted in a closed hearing."

When Is An Employee 'Drug Free'?

The new law does not define standards for determining whether an employee is drug free, Oglebay notes. Nor does it prevent your employer, or you personally, from being sued just for asking an employee to take a drug test, even if no discipline follows.

Oglebay says the safest approach to testing is to comply to the letter with drug-testing procedures as described in your employee handbook, manual, notices, or letters. "Random drug testing may be used only for extremely 'sensitive' jobs," she emphasizes. "But even employees in non-sensitive jobs should be asked to take a test only under the following guidelines established by the courts:

- **When there is a marked decrease in productivity over an extended period.** "An extended period can be as short as several weeks, but must be more than just a few days," Oglebay stresses.

- **When there is observable, "erratic behavior".** Since you know the people you supervise, it can be easy to spot, she maintains. For instance: Janet is suddenly crying all the time, Peter stares into space for 20 minutes at a time, Judy has frenetic bursts of activity, or Sam's movements are alternately very rapid or in slow motion. In situations like these, the courts have supported management's right to ask for a drug test.

- **"When the employer deems necessary".** You may ask an employee to take a drug test any time if the employee has signed a document agreeing to an employer policy of drug testing at will, or if the employee has been notified orally or in a company notice/letter that your employer now has a test-upon-request policy.

But, she warns, do not test in the following situations:

There is no documentable evidence of on-the-job drug use — or of drug use affecting performance. **Documentable** means something you can observe and write down.

The employee has been charged with — or even convicted of — a drug or alcohol offense. This is not proof of on-the-job use.

You hear a rumor that the employee uses drugs. Rumors are neither observable, nor documentable proof.

The employee admits using drugs off the job. It must be on the job.

Protecting Privacy

Oglebay recommends steps for protecting employee privacy:

Don't discuss a test with anyone other than the designated company official — not even the employee's direct supervisor.

SAMPLE EMPLOYEE STATEMENT

"I (name, title, location) _____ agree that as a condition of employment with (employer's name) _____, I will abide by the terms of this statement.

"I hereby acknowledge receipt of my employer's policy of maintaining a drugfree workplace."

"I hereby agree to notify my employer of any criminal drug-statute convictions for any violation occurring in the workplace no later than five days after any conviction."

"I Hereby acknowledge that in the event of any conviction for possession, manufacture, distribution, dispensation or use of a controlled substance in the workplace I will lose any privacy rights once the conviction is final, and I hereby waive all privacy rights that I have to this information."

"I hereby further authorize my employer to release any information concerning any violations by me under the Drug-Free Workplace Act in any unemployment compensation hearings, union arbitration, workers compensation, federal or state actions involving the terms of my employment, or internal company grievance or disciplinary procedures."

"I have read the above, acknowledge its receipt and agree to abide by the terms thereof."

/S/John Doe

Don't leave revealing notes or documents around — where anyone walking by or coming into the office can see them.

Don't discuss the drug test where you can be overheard. Never hold a conversation about a drug test in a hallway, on a factory floor or in any open area where others can hear.

Don't label a urine sample with an employee's name. Test vials are exposed at every step of the testing procedure. Instead, replace the employee's name on the label with a number.

Don't leave samples where they can be tampered with — or even where a claim of tampering could be made. For example, avoid leaving a test sample in the plant or office until it is sent to the lab. Instead, bring all samples directly to the place of storage.

Don't post 'passing' results. It allows co-workers to deduce who did not pass, opening the way for invasion-of-privacy lawsuits.

Safeguarding Test Results

Oglebay recommends keeping test results under lock and key - not in an employee's personnel file, she cautions, unless access to files is strictly limited to one or

NEW DRUG LAW, continue on page 6

NEW DRUG LAW, continued from page 5
two responsible executives.

When tests are positive, tell the employee. But to avoid acting on test-analysis errors, ask for a second test soon. "Urine tests are the easiest and least expensive ones to give, but also have a 20% error rate," she warns. "For example, marijuana and cocaine residues (metabolites) can show up in urine two weeks after use, yielding positive results based on off-the-job use."

However, Oglebay says, you may terminate people who fail a second test — even if positive tests results are from off-the-job use — if they are in "high risk" jobs: security jobs, high public-contact jobs, etc. To be on the safe side, she suggests warning the employee about the consequences of failing a second test.

"Passing" or "Failing" a Drug Test

The new act does not offer guidelines on when or how to test employees for abuse, or what level of residues pass or fail, Oglebay notes. The law says only that abusing a controlled substance is prohibited in the workplace.

But, she says, useful standards are available.

Oglebay advises applying the minimum pass/fail standards for residue or drugs in a urine specimen set by the Department of Transportation under Executive Order 12564 (Drug-Free Federal Workplace).

"Even if these levels are imperfect, and may change, using them shows your 'good-faith' attempt to separate on-the-job, under-the-influence drug use from drugs taken off the job," she says. "And using these standards can protect you in lawsuits under the many state laws that require that terminations for drug abuse be based on work-connected abuse. They can also save your employer the enormous expense of bringing an expensive biochemist or physicist into a hearing to testify."

TEST CHART	Confirmatory Test level (ng/ml)
Marijuana metabolite	15
Cocaine metabolite	150
Opiates:	
Morphine	300
Codeine	300
Phencyclidine	25
Amphetamines:	
Amphetamine	500
Methamphetamine	500

"Any employee whose urine test shows residues over the following levels fails the test and should be scheduled for a retest," Oglebay advises.

"Any employee whose urine retest within 72 hours of the initial test shows residues at or above the following levels fails the retest and may be subject to the discipli-

nary steps outlined in your employer's policy, which may include discharge," Oglebay says.

RETEST CHART (within 72 hours)	Initial Test Level (ng/ml)
Marijuana Metabolites	100
Cocaine metabolites	300
Opiate metabolites	300
Phencyclidine	25
Amphetamines	1,000

"The nitty-gritty responsibilities for complying with the Drug-Free Workplace Act of 1988 — informing employees about the employer's drug policy, getting employees to acknowledge they know about it, then enforcing it — are almost all at the supervisory level," Oglebay concludes. "But the consequences of falling short can hurt everybody who works on a federal contract, subcontract or grant. Until Congress or the courts fill in the many missing blanks in the new act, the best supervisors, managers, and employers can do is try to comply with the letter, however unclear it may be, and show their good-faith efforts to observe its spirit."

Excerpt from June 1989 The EEO Review.

EEOC ISSUES STANDARDS FOR EVALUATING SEXUAL HARASSMENT CHARGES

The Equal Employment Opportunity Commission (EEOC) issued a memorandum to help employers define sexual harassment and evaluate their liability for such conduct under Title VII. The memo clearly points out that a sexual harassment policy and other preventive steps taken by the employer can reduce potential liability. The memo sets standards for evaluating sexual harassment charges in accordance with the 1986 Supreme Court ruling in Meritor Savings Bank v. Vinson.

The memo discusses in detail the following issues and concerns:

- Determining whether alleged sexual advances were unwelcome;
- Assessing the credibility of the complainant and the alleged harasser (evaluating evidence);
- Determining whether alleged harassment creates a hostile environment (including isolated and non physical incidents and sex-based harassment);

EEOC, continue on page 7

EEOC, continued from page 6

- Evaluating liability for sexual harassment by a supervisor;
- Establishing components for an effective program to prevent sexual harassment.

In addressing these issues in the Vinson case, the EEOC emphasizes that voluntary submission to sexual harassment does not necessarily defeat a claim of sexual harassment. With conflicting evidence, claims are strengthened if a report or protest is made by the charging party while the harassment is ongoing or immediately thereafter.

An employer's liability will be minimized under the above circumstances if an effective internal investigation or reporting procedure exists and is clearly and often communicated to all employees.

However, employer liability will not automatically be lessened on the basis of "ignorance" of the alleged harassment. If victims are not encouraged to object to management, or if sexual harassment is not promptly addressed in the workplace, the employer liability rises. The absence of a reporting process can lead to a claim of "hostile" work environment because the issue is ignored or not given credibility.

In the case of sexual harassment by a supervisor, employers will be held liable for acts of "quid pro quo" harassment. This occurs when a supervisor uses his or her authority to hire, fire or promote in return for sexual considerations or because of lack of sexual acquiescence.

If confusion exists concerning whether the supervisor was acting within the scope of his or her employment, an employer's failure to stop work-related sexual misconduct, once aware of it, will bring the actions within that scope and result in employer liability.

Employers are also responsible for supervisor actions which appear to be authorized. This apparent authority will be found where the employer has neither a widely distributed and consistently enforced policy against sexual harassment nor an effective grievance procedure. Employers can limit a supervisor's apparent authority by implementing and maintaining an effective reporting procedure.

If a victim of sexual harassment fails to use an established reporting procedure, the employer may be liable for supervisory sexual misconduct if the employer learns about it and does not take remedial action.

The best method of reducing employer liability is to have an explicit sexual harassment prevention policy which includes a reporting procedure. This policy must be made known and explained to all employees and must always be implemented when a sexual harassment report arises. The employer must make it known that he stands behind and utilizes the policy.

Any procedure for solving sexual harassment reports

should ensure confidentiality, provide effective remedies, and guard against retaliation. The employer must do whatever is necessary to end the harassment and prevent a recurrence.

For more information call Vicky Koch at (406) 444-6331.

Except from April 1989 Montana Personnel Perspectives.

SURETY UNDERWRITING CONSIDERATIONS

(This article will help you identify the information commonly requested by a surety company to initiate a bond relationship between a contractor and surety, and help you understand how this information may be interpreted. It will also review the questions generally asked by a surety for a specific bond request and will consider specific events which require additional explanation by the contractor to the surety company.)

The surety industry is ever-changing. Therefore, this article should be used as a general guide.

In general, a surety company will investigate three areas of a contractor's makeup: character, experience, and capacity (both physical and financial). The investigation will begin with a meeting between the contractor and the professional surety agent. The agent, being familiar with the construction industry and the surety credit function, can assess the contractor's bond needs and gather the necessary information. The information a contractor should be ready to supply a surety company would include:

- Written business plan addressing: strengths and weaknesses of operations; market threats and opportunities; competitive factors; risk analysis of desired work program; financial forecast (including cash flow, income, expense, and profit); goals and objectives (including method of attainment and who is responsible for each objective).
- Organization chart
- Resumes (all owners and key employees)
- Completed contract schedule (largest work completed to date including description, owner address, final contract price, final gross profit, and completion date. Also include project management team, superintendent, project manager, etc.)
- Continuity (explain provisions implemented, such as key man life insurance, employment agreement

SURETY UNDERWRITING, continue on page 8

with key employees, buy/sell agreement, etc.)

- References (owner, architect, subcontractor, and supplier by name, address, and phone numbers) and letters of recommendation

- Bank line of credit (letter from bank confirming the amount, terms, and conditions of the working capital line of credit)

- Corporate financial statement, fiscal year end statements from the last three years, and the most interim statement

- Personal financial statement (concurrent with the most recent fiscal statement) of all owners

- Work on hand schedule (detailed schedule of backlog as of a recent date)

- Contractor's questionnaire (completed)

The information outlined above will assist the agent and ultimately the underwriter in evaluating the ability of the contractor to complete all work undertaken in accordance with contract terms and conditions, and to meet the required financial obligations.

Character. The question now becomes: what does a surety look for in the information provided? Each surety treats the information somewhat differently, so there is not a single definitive answer.

The investigation into character of the key individuals is primarily based upon demonstration business practices, references, and face-to-face meetings between the contractor, agent, and surety. This character investigation is important because the surety credit is for the most part "unsecured" — because there generally is no specific collateral or assignment taken against assets to secure a surety's credit interest.

- Business practices: Dunn & Bradstreet report; aged schedule of accounts payable; aged schedule of accounts receivable; claim activity

- References: direct third party response

- Opinion: derived from direct conversations with management concerning business philosophy, attitudes, etc.

Summarized, the surety wants to satisfy itself that the contractor is well managed, has a history of paying subcontractors and suppliers promptly, keeps promises, deals fairly, and performs obligations in a timely manner.

Experience. The investigation into experience focuses on the background of key employees (both inside and out) and work previously completed by the contracting entity. The surety looks at the ability of the organization to address administrative, estimating, and field responsibilities at the current or anticipated level of operations. Specifics to be addressed include:

- Ability to process paperwork (change orders, requisitions, billings, etc.)

- Quality of cost accounting records

- Understanding of financial records, cash flow projections, business plan, etc.

- Prior job experience of contracting entity: classification of construction, location of construction, size and scope of work, recommendations from previous owners and architects, profitability of projects

- Prior experience of estimating and field employees.

- Organization chart identifying responsibilities, and matching it to the project backlog (size, type, location, and number of projects)

In essence, the surety will attempt to identify all key employees (both inside and out), define their responsibilities and prior experience, and determine whether there is adequate technical expertise and administration, estimating, and construction capability to do the contemplated work. It will also attempt to review the job experience of the contracting organization.

Capital. The surety's review of "character" and "experience" is generally better understood than its review of "capital." Capital takes into consideration the contractor's ability to apply assets to the construction process. These assets are defined as both financial (working capital and net worth) and physical (equipment and real estate).

Physical capital is evaluated from the perspective of:

- Its borrowing capacity (if it is unencumbered)

- The contribution it makes to assist the completion of work undertaken, such as paving equipment owned by a paving contractor.

- Its adequacy and adaptability to do the work undertaken

Financial capital is evaluated through the financial statements. It is important that the financial information be presented in a manner consistent with the American Institute of Certified Public Accounts (AICPA) guidelines (sometimes referred to as "Example Contractor Format") and prepared by a competent CPA experienced in construction accounting. This helps build surety confidence in the information provided.

These AICPA guidelines call for, and sureties are requesting, statements to be prepared on a percentage of completion basis with appropriate support schedules including completed contracts, contracts in progress, indirect construction costs, and general and administrative costs. Because the financial statements are the focal point of the capital analysis, it is very important that they be presented in this unique format. Frequently, financial statements not prepared in the AICPA format contain massive schedules of numbers that turn out to be useless because they fail to highlight the summary numbers from which conclusions can be drawn.

The financial statements are analyzed by the surety to ascertain financial strength and profitability. The analysis consists primarily of a gross profit analysis and financial ratio analysis.

SURETY UNDERWRITING, continue on page 9

SURETY UNDERWRITING, continued from page 8

Sample financial statements may be obtained from Denton Hammond, National Construction Industry Director with Grant Thornton in Atlanta, Georgia.

The gross profit analysis concentrates on the supplementary information and reviews the contractor's estimating skills. It considers:

- The overall gross profit determinable by analysis of the statement of earnings.

- The portion of gross profit that is known and realized on completed contracts compared to the portion that is subject to estimation and recognized on jobs still in progress.

- How the gross profit rate actually realized on completed contracts compares to that estimated at interim reporting periods while the jobs were in progress.

- Whether the gross profit remaining on jobs in progress and jobs sold after the balance sheet date can cover next year's general and administrative expenses

The financial ratio analysis will concentrate on liquidity, net worth and profitability measures. (See page 26 for a schedule of the more common ratios and measures used by some sureties.) As mentioned earlier, sureties view these ratios and measures differently, and place varying degrees of importance on each. The two measures emphasized universally are "working capital" and "net worth." The analysis makes adjustments for items that are interpreted differently by the surety, when compared to the classification of the CPA. If an asset value or collectibility is questionable, the surety will take the more conservative approach in evaluating the asset (i.e., aged receivables, claims, inventory, valuation on a current basis) and either discount it or not allow the asset at all in its evaluation. Surety companies do differentiate in their analyses between equipment- and labor-intensive contractors. They also differentiate between small and large contractors.

The analysis of working capital (current assets minus current liabilities) is designed to indicate a contractor's ability to reasonably fund operating cash flow needs, and whether a reserve is available to handle the "problem" account receivable or claim. The underwriter will also review working capital to the cost to complete backlog. This is a measure of working capital leverage. This ratio has fluctuated greatly over the years. Ordinarily this ratio might be five percent to ten percent, but may be as low as one percent to two percent, or as high as 20 percent to 30 percent. Another factor that affects this range is the actual liquidity ratio in comparison to the comfort levels (as outlined in the sample schedule).

The analysis of net worth is designed to indicate a contractor's ability to absorb a loss. The surety will analyze the net worth together with the working capital to arrive at an approximate level of backlog the surety feels the contractor can support. Included in this assessment is

an analysis of profitability (both historical and anticipated). Figures such as gross profits as a percent of sales can give insight into a company as well as direction of an industry. The success of many contractors is dependent on their ability to control their general and administrative expenses as market cycles pass. This information is garnered from prior financial statements and current work on hand schedules.

Most surety companies require periodic updates of the contractor's work in process (sometimes called "status of contractors"). This schedule is an indicator of future cash flow and profitability, and thus its importance cannot be over-stressed. As with a computer, only if accurate information is entered into the schedule will the resulting information be useful. Conversely, inaccurate data produces useless information. For a complete explanation of the analysis performed on the schedule, talk to a professional surety agent.

All of the preceding information is considered by a surety to establish and maintain a surety program. Even after the program is established, the surety will review each project when a bond is requested. Information a surety would look for on a specific job would include the following:

- Type of work and prior experience
- Scheduling on this project into current program: management time, field supervision, equipment, cash flow projections
- Completion schedule
- Liquidated or actual damages
- Payment terms
- Design, efficiency, or warranty guarantees
- Force majeure clauses
- Contract rights
- Insurance (hold harmless clauses, pollution, etc.)
- General contract language
- Current backlog of contractor's work

Even after successfully addressing all of the preceding, events may cause the surety to investigate further. The following is a list of the more common "red flags" that will cause an underwriter to dig further. The contractor should be ready to address them.

- Entering new geographical areas
- History of contract profits fades as projects approach completion
- Inadequate construction volume to cover general and administrative expenses
- Excessive construction volume
- Excessive overhead expenses
- Problem receivables or claims
- Excessive amounts of fixed assets
- Outside investments
- Entering different classifications of construction
- Unusual litigation
- Deterioration of payment history
- Continual complaints from subcontractors and suppliers

SURETY UNDERWRITING, continue on page 10

COMMON FINANCIAL RATIOS:

Ratios and Measures	Calculation	Comfort Range
<u>Liquidity Measures:</u>		
Number of Days Cash	$\frac{\text{Cash} + \text{Equivalent}}{\text{Annual Revenue}} \times 360$	7 Days or More
Accounts Receivable Turnover	$\frac{\text{Accounts Receivable} \times 360}{\text{Revenue}}$	60 Days or Less
Accounts Payable Turnover	$\frac{\text{Accounts Payable} \times 360}{(\text{Cost of Earned Revenue})}$	45 Days or Less
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Greater Than 1.2 Times
Working Capital to Backlog	$\frac{\text{Working Capital}}{\text{Cost-to-Complete Backlog}}$	5% to 10% or Greater
Aging of Accounts Receivable and Payable		60 Days or Less
Average Daily Account Balances		Varies as to Size and Industry
<u>Net Worth Measures:</u>		
Debt to Net Worth	$\frac{\text{Total Debt}}{\text{Net Worth}}$	2.1 to 3.1
Fixed Asset to Net Worth	$\frac{\text{Fixed Assets}}{\text{Net Worth}}$	10% to 40%
Net Worth to Backlog	$\frac{\text{Net Worth}}{\text{Cost-to-Complete Backlog}}$	5% to 10% or Greater
Sales to Net Worth	$\frac{\text{Annual Revenue}}{\text{Net Worth}}$	10
<u>Profitability Measures:</u>		
Gross Profit to Sales	$\frac{\text{Gross Profit}}{\text{Annual Revenue}}$	Varies as to Industry
Overhead to Sales	$\frac{\text{General \& Administrative Expense}}{\text{Annual Revenue}}$	Varies as to Industry
Overhead to Net Worth	$\frac{\text{General \& Administrative Expense}}{\text{Net Worth}}$	60% or Less
NPBT to Sales	$\frac{\text{Net Profit Before Taxes}}{\text{Annual Revenue}}$	2% or Greater
Return on Equity	$\frac{\text{Net Profit Before Taxes}}{\text{Net Worth of Prior Year}}$	15% or Greater

Underwriting Criteria

This article has been prepared by the National Association of Surety Bond Producers, an association organized in 1943 to enable professional surety bond producers to anticipate and solve problems, to develop professional standards for the industry, and to promote public and governmental understanding and recognition of the value of suretyship.

Excerpt from May 1989 Intermountain Contractor.

COMPUTERIZED CONSTRUCTION ACCOUNTING SOFTWARE CRITERIA

When you look for computerized software for your construction business, here are some ideas to help you.

First, be aware that the computer salesperson may try to sell you something "general"; not specifically designed for construction accounting. Don't buy that; it will just frustrate you and your office staff.

Now, here is a "shopper's guide" for a computerized construction accounting system. The criteria are roughly in order of importance. Good luck in your search.

PAYROLL

- _____ 1. Integrates with job cost
- _____ 2. Allows multiple wage rates per employee per pay period
- _____ 3. Is easily used for multiple states
- _____ 4. Tracks hours at regular rate for Workers' Comp purposes
- _____ 5. Allows multiple Workers' Comp classifications per employee
- _____ 6. Prepares certified payroll reports including "pink sheet" classifications
- _____ 7. Is flexible in withholding and deduction area, i.e., vacation, other benefits
- _____ 8. Has a provision for computing and posting a payroll overhead factor to job cost
- _____ 9. Has easy to change withholding table and other payroll tax rates
- _____ 10. Prepares W-2's and quarterly reports
- _____ 11. Prepares union benefits reports
- _____ 12. Prints hours and wage rates on employee's pay check stub

JOB COST

- _____ 1. Is fully integrated with general ledger, payroll and accounts payable
- _____ 2. Tracks job costs by phase (mobilization, concrete, excavation, pipe, etc.)
- _____ 3. Tracks job costs by cost type (labor, material, equipment, overhead, subcontracts)
- _____ 4. Has a provision to enter a budget for job cost comparison purposes
- _____ 5. Allows entries from the general journal
- _____ 6. Does not allow entries to job cost that don't automatically post to the general ledger
- _____ 7. Stores job related information over the end of

an accounting period

- _____ 8. Has a provision to calculate percentage-of-completion
- _____ 9. Calculates and reports on variances
- _____ 10. Tracks hours (or units) on reports and compares to budget
- _____ 11. Keeps historical information on job (owner, address, contract number, completion date, change orders)

GENERAL LEDGER

- _____ 1. Integrates with job cost
- _____ 2. Allows journal entries to job costs
- _____ 3. Accumulates job costs in either current assets or in cost of goods sold depending on method of income recognition used (completed contract vs. percentage of completion)
- _____ 4. Has flexible and "roomy" chart of accounts
- _____ 5. Does not allow out-of-balance entries
- _____ 6. Allows adjustments to earlier periods

ACCOUNTS RECEIVABLE

- _____ 1. Has billing or AIA % of completion billing
- _____ 2. Has a provision for tracking retained percentages

ACCOUNTS PAYABLE

- _____ 1. Integrates with job cost
- _____ 2. Splits invoices to multiple jobs as well as inventory and/or G & A
- _____ 3. Allows for use of purchase orders
- _____ 4. Ages accounts and prints aging reports

Prepared by Brooke Flynn of Metro Business Associates, Inc., under contract to the Montana Department of Highways.

COMPLIANCE REVIEWS AND UTILIZATION ANALYSIS

To achieve employment goals on a federal-aid highway project, a contractor must provide the requisite number of hours in each craft to accomplish the required minority/female percentages. However, when these percentages cannot be attained, assuming new employees are hired, a utilization analysis must be prepared. Based on construction employment patterns of previous years,

COMPLIANCE REVIEW, continuepn page 12

COMPLIANCE REVIEW, continued from page 11

the following areas are the most likely to be underutilized by both females and minorities:

Operating Engineers, Cement Masons, Ironworkers, and Truck Drivers.

"Underutilization" is defined as having fewer females or minorities in a particular job group than would reasonably be expected by their availability.

A separate utilization analysis should be developed for minorities if needed and/or females if needed. The following steps, as outlined in 41 CFR 60-2.11, shall be followed when compiling a utilization analysis for submittal with the compliance review documents.

In determining whether minorities and/or females are being underutilized in any job group, the contractor will consider at least all of the following factors:

(i) The minority/female population of the labor area surrounding the facility;

(ii) The size of the minority/female unemployment force in the labor area surrounding the facility;

(iii) The percentage of the minority/female work force as compared with the total work force in the immediate labor area;

(iv) The general availability of minorities/females having the requisite skills in the immediate labor area.

(v) The general availability of minorities/females having the requisite skills in an area in which the contractor can reasonably recruit;

(vi) The availability of promotable and transferable minorities/females within the contractor's organization;

(vii) The existence of training institutions capable of training persons in the requisite skills; and

(viii) The degree of training which the contractors is reasonably able to undertake as a means of making all job classes available to minorities/females.

Current labor force information is available from the Department of Administration, Census Bureau, Capitol Station, Helena, Montana 59620.

When a contractor, who is undergoing an MDOH compliance review, has not achieved employment goals for females and minorities a utilization analysis must be prepared and submitted with the pre-review data.

If you have any questions regarding the compilation of a utilization analysis call Sam Prestipino at (406) 444-6331.

Invitation For Bids

Excerpt from the July 10, 1989 Intermountain Contractor.

Jul 25

HEAT RECLAIMER, FORT HARRISON

Bid opg offc of ownr. Ownr: Chief, sSupply Service (90)
VA Medical & Regional Offc Bldg 141, Room 208, Fort
Harrison, MT 59636, (406)442-6410, Ext 357, attn:
Michael Burtch.

Jul 25, 2:00pm, Est: \$150,000-\$250,000

CONVENIENCE STORE & CAR WASH

Great Falls MT (Cascade Co) Tenth Ave S

GC BID TO ARCH JUL 25 aAT 2PM (MDT) Owner: Town
Pump Inc & Affiliates Dan Kenneally (Gen Mgr) 600 S
Main St, Butte, MT 59701, (406)782-9121.

Jul 26, 2:00 pm, Est: \$100,-\$250,000

REPLACE WINDOWS, CAPEHART HOUSING, MALM-
STROM AFB

BIDS TO OWNER. Owner: Operational Contrg Div, Bldg
145, Malmstrom AFB, MT 59402-5320, (406)731-2895.

Dept of Administration Invitation For Bid

Sealed bids will be received until 2:00 PM on
August 2, 1989, and will be publicly opened and read
aloud in the offices of the Architecture & Engineering
Div., 1520 East Sixth Ave., Helena, MT, for

**REMODEL UNIT NO. 57 for WOMEN'S COR-
RECTIONAL CENTER ANNEX, MONTANA
STATE HOSPITAL, WARM SPRINGS, MON-
TANA, MONT A/E 89-11-05RM.**

Bids shall be submitted on the form provided with
the contract documents. Contract documents may be
secured at the office of the Architecture & Engineering
Div., 1520 East Sixth Ave., Helena, MT.

Bids shall accompanied by bid security meeting the
requirements of the State of Montana in the amount of
10% of the total bid. The Successful bidder will furnish
approved Performance Security and Labor and Material
Security in the amount of 100% of the contract.

The contractor shall comply with all fair labor prac-
tices and state statutes.

Each bidder and subcontractor for work over \$5,000
must have a valid Montana Public Contractor's License in
the proper classification.

No bidder may withdraw his bid for at least 30 days
after the scheduled time for receipt of bids except as
noted in the Instruction to Bidders.

The Owner reserves the right to reject any or all bids
and to waive any irregularities or informalities.

1000

MONTANA STATE LIBRARY
ATTN: HAROLD CHAMBERS (4)
DEADHEAD

**Civil Rights Bureau
Montana Department of Highways
2701 Prospect Avenue
Helena, MT 59620**

1100 copies of this public document were published at an estimated cost of \$.42 per copy for a total cost of \$459.79 which includes \$252.02 for printing and 207.77 for distribution.